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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re ATM FEE ANTITRUST LITIGATION

Master File No.: C04-2676 CRB

CLASS ACTION

**DECLARATION OF DENNIS F. LYNCH
IN SUPPORT OF DEFENDANTS'
MOTION FOR SUMMARY JUDGMENT
ON PLAINTIFFS' PER SE CLAIM**

This Document Relates To:

ALL ACTIONS

Date: October 5, 2007
Time: 10:00 a.m.
Courtroom: 8

Honorable Charles R. Breyer

I, Dennis F. Lynch, declare:

1. I am a resident of New Canaan, Connecticut. I am not affiliated with any of the parties in this action. I have been retained by the Defendants in this action to testify as an independent expert regarding: (1) the history of U.S. payments networks and policies; (2) rationales for the use of interchange fees in ATM networks in the United States; and (3) evaluation of

1 alternative arrangements for interchanging transactions for networks, institutions and companies. I
 2 make this declaration based on my own personal knowledge and experience and on facts personally
 3 known to me and/or which I identify as having been provided to me for purposes of forming and
 4 rendering the opinions set forth below. The opinions set forth herein are my own and, if called as
 5 witness, I could testify competently to each of the matters stated in this declaration.

6 7 I

8 9 PERSONAL HISTORY AND QUALIFICATIONS

10 2. I hold Bachelors and Masters Degrees from the University of Rhode Island.

11 3. I joined Fleet Bank in 1981. My initial position at Fleet was in the Information
 12 Systems division, where I was responsible for a variety of system development efforts. I later
 13 became a Senior Vice President of Fleet with responsibility for the business development and
 14 marketing of self-service products (ATMs, card products, phone services, and emerging products)
 15 throughout New York and New England. I was with Fleet until 1994.

16 4. From 1992 to 1994, I was a Director on the NYCE ATM Network Board. I joined
 17 NYCE full-time in 1994 as Executive Vice President and Chief Operating Officer. I served as
 18 President and Chief Executive Officer of NYCE Corporation from 1996 to 2004. During my tenure,
 19 NYCE grew from a Northeastern U.S.-focused company into an organization with a national
 20 footprint, processing over 1.2 billion consumer payments serving 2100 financial institutions and over
 21 1 million retailers. At the time I left it, NYCE was one of the three largest surviving networks of the
 22 original 200 "regional" ATM networks across the country.

23 5. I was a founding Director of the New England-wide Yankee 24 ATM Network. I
 24 served as its Chairman from 1988 to 1990.
 25
 26
 27
 28

1 6. From 1996 to 2004, I served on the Executive Committee and the Board of the
2 Electronic Funds Transfer Association (EFTA).

3
4 7. I am a past Chairman of the Network Executive Council and have served on the
5 Board of Directors of the Smart Card Forum and Everlink, a Canadian ATM network joint venture.

6
7 8. I have a total over 25 years' experience in the ATM card products and payment
8 solutions industry.

9
10 9. In addition to relying upon my personal industry experience to prepare this
11 declaration, I have undertaken the following to assist me in preparing the opinions set forth below:

12
13 a. I conducted a telephone interview of Elizabeth Lynn, who currently serves as
14 the Senior Vice President of Strategy and Portfolio Management for First Data Debit Services; and

15
16 b. I reviewed the following documents:

17
18 (i) 2005, 2006 and 2007 EFT Databooks;

19
20 (ii) 2006 Kansas Federal Study on ATM and debit card industry;

21
22 (iii) STAR Operating Rules.

23
24 10. I have not authored any publications within the last 10 years that relate to any of the
25 subjects on which I have been asked to opine in this matter. I was deposed by the justice department
26 as part of its lawsuit blocking the 2003 proposed merger of FDC and Concord, but I have not
27 otherwise testified as an expert witness in any action within the last four years. To the best of my
28

ability to gather the information at this time, I have given the following presentations or speeches within the last 10 years:

- a. Keynote address for the NYCE annual conference, 1996-2002;
- b. Keynote address for the 2003 PSCU annual conference;
- c. Presentation at the 2002 FDCC annual customer conference;
- d. Presentation at the NACHA annual conference in 2000 (est.);
- e. Keynote address at the annual ISO conference in 2001 (est.).

11. I am being compensated for my time on this engagement at the rate of \$650.00 per hour, plus reimbursement of my expenses.

II

OVERVIEW HISTORY OF ATMs AND ATM NETWORKS

12. The financial services industry in the United States includes thousands of financial institutions such as commercial banks, savings & loans, savings banks, thrifts, credit unions and other types of depository institutions that provide deposit and cash withdrawal services to consumers. For convenience only, I refer to all of these different types of entities collectively below as "banks." Banks often have very different business strategies and interests. While many banks are large and have hundreds of branches and thousands of ATMs across states, regions or the country, a substantial number are small and may have a single branch with no ATMs.

13. Despite having widely differing strategies and positions in the industry, banks nonetheless have in recent decades relied upon cooperative, or "network," arrangements in order to

1 provide geographically ubiquitous financial services to consumers via electronic systems. For
2 example, networks of participating banks make it possible today for consumers to have cash access
3 to their accounts at hundreds of thousands of ATMs across the U.S., or to use their credit and debit
4 cards at millions of merchant locations throughout the country, even when the consumer's card is
5 issued by a small or geographically remote bank. The Star ATM network involved in this action is
6 just one of many examples of such a network.

7
8 **A. Automated Teller Machines (ATMs)**

9
10 14. Since the late 1970s the vast majority of banks have deployed ATMs in order to
11 permit their customers to use an "ATM card" (or a "debit card") to electronically execute cash
12 withdrawal transactions from the card-issuing bank. ATMs provide consumers with a service that
13 was not available before their introduction - quick and easy access to cash from a consumer's deposit
14 account, twenty-four hours a day, seven days a week.

15
16 15. In the 1970s, almost all ATMs were located at or near a branch office of the bank that
17 deployed them. The primary function of an ATM was to service the card-issuing bank's own
18 customers by providing additional hours when they could withdraw cash from their accounts,
19 without the need to add tellers or extend branch operating hours. As time passed, some banks also
20 began installing ATMs at new locations separated from, and often physically distant from, their
21 branch offices. These so-called "off-premises" ATMs (as opposed to "on-premises" ATMs located
22 at a branch office) were typically located so as to increase customer access to withdrawal services
23 without the need to build or operate an entire new branch.

24
25 16. Today, most banks of any significant size deploy at least some ATMs. However,
26 many smaller banks still do not make the capital and operating expense investment required to
27 deploy ATMs. And, even for customers of banks that do deploy ATMs, the convenience of an ATM
28 deployed by the bank is still limited by the bank's geographic footprint and investment capacity.

Thus, the inherent limits on the number of ATMs that any one bank can efficiently deploy means that consumers often do not have access to their own bank's ATM services outside the bank's service area. Even within that service area access can be, and often is, limited by the number and location of the ATMs deployed by the bank. To address this customer service issue, the industry developed, and for decades now has relied upon, ATM networks to provide broadly accessible ATM service to consumers throughout the United States (and the world).

B. ATM Networks

17. An ATM network is a system that allows the customer of one participating bank to execute ATM transactions at ATMs owned or operated by any other network participant under network-established conditions that are designed to assure reliability and certainty by prescribing exactly how those transactions will take place. An ATM network thus establishes a uniform set of operating "rules" and administrative functions that: (a) electronically link all ATMs deployed by entities that contract with the ATM network and make them all available for "real-time" transactions conducted by any cardholder of any network-participating bank; and (b) obligate the entities involved in the transaction to complete it upon pre-arranged conditions that assures each entity that the other will perform its obligations when properly requested. Thus, through an ATM network, an ATM card-issuing bank (sometimes referred to in the industry as the "issuer") can offer to consumers the ability to withdraw cash (or check an account balance or transfer funds between accounts) at an ATM owned by another entity (sometimes referred to in the industry as the transaction "acquirer")¹, even though the acquirer is unrelated to the consumer's bank and even though their consumer's bank and the acquirer are contractual strangers. An ATM network thus provides a resource that would be economically impossible for any single bank, even the largest banks, to offer to consumers. Access to that resource benefits all banks participating in an ATM

¹ For the sake of simplicity, I use the term "ATM owner" in this declaration to refer to the entity that deploys, or operates, an ATM. Most ATM owners are also the deployers of the ATM, but there are some examples of ATMs that are legally owned by one entity and yet deployed by another.

1 network, but is particularly beneficial to the smallest banks, whose ability to deploy ATMs lags far
2 behind that of their larger competitors.

3
4 18. In a typical ATM network cash withdrawal transaction, the ATM owner sends a
5 message to the network indicating that a cardholder has asked to withdraw cash. The network sends
6 the message to the card-issuing bank asking for authorization for the transaction. The card-issuing
7 bank transmits an immediate response back to the network, approving or denying the request. The
8 network then routes the message back to the ATM owner, which, upon approval, proceeds to
9 dispense the cash requested. No matter how far apart the ATM and the consumer's bank may be,
10 and no matter what time of day the transaction occurs, this entire process is designed to take place
11 within seconds so that the consumer is provided convenient and rapid access to her deposit account.

12
13 19. The ATM network also establishes the binding conditions, or network "rules," under
14 which this transaction takes place. These rules, which I discuss in more detail below, govern –
15 among many other things - the settlement of all network transactions, including the amount, timing
16 and other conditions through which the ATM owner, having been asked to disburse cash at one of its
17 ATMs to a cardholder of the issuer bank, is to receive payment for making that disbursement. The
18 ATM network's conditions thus substitute for a direct contractual agreement between the ATM
19 owner and the card issuer by facilitating the promise of the issuer to provide appropriate payment to
20 the ATM owner for providing a service to the consumer – the issuer's customer. Through this
21 network commitment, an ATM owner can disburse cash from its ATM, knowing that it will be paid
22 by the issuer bank in accordance with a pre-arranged set of conditions.

23
24 **C. Origins and Early Objectives of Networks**

25
26 20. The earliest ATM networks in the U.S. were formed as partnerships or joint ventures
27 owned by small groups of banks looking to expand their customer services at a local or regional
28 level so as to provide broader cash access to their consumers by enabling them to use ATMs that

1 were not owned or operated by the consumer's bank ("foreign ATMs"). Banks joined networks in
 2 order to enhance the ATM services offered to their own customers and to increase the bank's ability
 3 to compete for additional depositors. These motives were particularly important to smaller banks
 4 (including thrift institutions and credit unions) that had very limited branch office, or "on-premises,"
 5 ATM deployment. The initial ownership structure of these networks was primarily associational in
 6 nature and not-for-profit by structure. While some networks were owned by a subset of the
 7 participating banks, a large number were owned or "shared" by every bank that belonged. In these
 8 cases all of the participating members typically had some voting rights, which might vary according
 9 to the type, size, or network transaction volume of the particular bank.

11 21. Because ATMs were still a somewhat novel banking method for many consumers in
 12 the 1970's and into the 1980's, an overriding objective of early ATM networks was to build local
 13 brand recognition and consumer acceptance by attracting as many local banks as network
 14 participants as possible and, by doing so, to increase the numbers of cardholders, ATM machines
 15 and transactions within the network. This growth accomplished the complementary objectives of:
 16 (a) increasing the number of participating ATMs from which participating banks' customers could
 17 obtain cash; and (b) increasing the number of network transactions, and resulting "switch" revenue
 18 for the network,² thereby permitting the network to fund further growth for the benefit of its
 19 participating banks.

21 22. As new networks were formed and grew and competed with one another, the success
 22 of each ATM network remained critically dependent on the volume of transactions it could attract
 23 and process. That required competition for banks and, through those banks, for: (1) greater
 24 geographic coverage and density of ATM deployment; (2) a larger number of cardholders; and (3)
 25 the use of the network for transaction processing.

26 ² For every network ATM transaction, the card-issuing bank is required to pay a network-set "switch" fee to the network
 27 for facilitating and communicating the transaction between ATM owner and the card-issuer. These switch fees have
 28 varied in amount among networks, but in each case switch fees would be the network's principal source of revenue.

D. The Development and Purposes of ATM Network Rules

23. At the outset, banks were encouraged to join networks by the adoption of a comprehensive set of network “ground rules” based on the understanding that each participating bank and its customers would be treated fairly and no single network participant could gain advantage at the expense of others. This “level playing field” approach ran as well to a full range of requirements for network participation, including operations, technology, branding and pricing. Each bank in the network had to enter into a binding contract with the network that obligated the bank to abide by all of these rules.

24. This comprehensive set of network operating rules allowed participating banks (which were themselves contractual strangers) to understand their obligations and to be able to properly set their expectations. As a result, every card-issuing bank could trust that its customers’ network-branded cards would always work in every network-branded ATM (sometimes referred to as “universal acceptance” and/or “full participation”), and every ATM owner could be assured, in advance, of the certainty of reimbursement for cash dispensed and payment of a fee for servicing the cardholder. Further, every network participant, and thus consumers, could reasonably expect technical and operational reliability at every network ATM and within the network’s switching, settlement and processing systems, such that every “foreign” ATM transaction would be processed in real-time and then ultimately settled and recorded accurately.

25. I have reviewed the rules of the Star network, and they are generally similar to other ATM networks’ rules with which I have been familiar in that they reflect a balancing of the obligations, rights, benefits and potential liabilities of all participants in the network. Specifically, Star’s rules regarding full participation and advance agreement on fees and reimbursement follow generally with historical and recent industry practice.

E. Linkage between Universal Acceptance and Interchange Fees

26. Universal acceptance requires that participants in a network agree in advance that they will honor all properly presented and authorized transactions from each and every other network participant. All major U.S. ATM network rules with which I am familiar incorporate the principle of universal acceptance, *i.e.*, every ATM card issued by a participating bank must be accepted by every ATM owned by a participating bank or by a participating ISO. A critical issue that all such rules must (and do) address to facilitate universal acceptance is the terms under which an ATM owner will be paid by the card-issuer bank in a foreign transaction. The ATM owner must be certain of the timing and amount of payment before it will accept a “foreign” transaction through the network.

27. In my experience, neither issuer banks nor ATM owners will agree to participate in an ATM network unless they know in advance all of the material terms of the network transactions they would be obligated to fulfill or entitled to receive. Thus, the principle of universal acceptance in ATM network rules has always gone hand-in-hand in the industry with the principle that there must be certainty of the amount that must be paid by the card issuer bank to the ATM owner for accepting the issuer’s cards—including the amount of the cash advanced and the amount of any fee for performing this service to the card-issuer bank for providing cash to that bank’s customer. This latter payment is usually described as the “interchange fee.” These acceptance, repayment and compensation principles have been long used, and are now embodied, in all the major ATM network rules in the U.S. of which I am aware. In my experience and opinion, these principles cannot be separated by any network that seeks to compete effectively for participants.

28. By contrast, if a bank’s network branded/coded ATM cards were not universally accepted at all ATMs within the network, the bank’s customer would likely be annoyed upon finding that her card did not ensure ready access to cash at an ATM location. This would undermine the central benefit of the ATM network to consumers, and thus would not be accepted by the issuer

1 bank. Issuer banks would view anything less than universal acceptance as an inconvenience, or an
 2 inferior product, for their customers and would take the position that they would be exposed to the
 3 risk that their customers would switch their accounts to banks affiliated with an ATM network(s)
 4 that offered greater certainty. Similarly, ATM owners would not agree to join an ATM network that
 5 did not offer them advance certainty of payment for a foreign ATM transaction conducted through
 6 the network. Neither would ATM owners agree to join an ATM network that did not offer universal
 7 acceptance of network cards because such a circumstance could reduce the volume of successfully
 8 completed ATM transactions while increasing the ATM owner's service costs associated with failed
 9 transactions.

10 **F. The Origin of ATM Interchange Fees**

11
 12 29. In order to compensate an ATM owner for handling a "foreign" cash withdrawal,
 13 virtually every U.S. network has established, by rule, a system-wide interchange fee that is assessed
 14 on the card issuer bank, added to the principal amount of the withdrawal and then passed, via the
 15 network, to the ATM owner. In fact, the interchange fee was an important component of early ATM
 16 network strategy because it was a form of compensation for the transaction cost borne by the ATM-
 17 owning bank and (particularly for banks with large ATM fleets) for servicing a customer of a
 18 competing bank. The ATM interchange fee was specifically used to attract ATM-owning banks to
 19 join the network, thus increasing the number and locations of ATMs available to network
 20 participants (and consumers) and concurrently increasing potential transaction flow for the network.
 21

22 30. Network membership from the outset involved: (1) banks that owned few ATMs and
 23 thus typically paid more in total interchange fees for "foreign" ATM transactions by their customers
 24 than the bank received from use of its ATMs by customers of other banks ("net issuers"); and (2)
 25 banks that owned many ATMs and typically received total interchange fees that exceeded the total
 26 amount of interchange fees that the bank paid out for its customers' foreign ATM transactions ("net
 27 acquirers"). Thus each network had to try balance these competing interests when it set interchange
 28

1 fees to try to encourage both net issuers and net acquirers to participate in the network. Networks
2 typically did this by setting their interchange fee high enough to reasonably reward net acquirers, but
3 not so high as to discourage net issuers from joining the network.

4
5 31. As the joint venture ATM networks have been sold to independent proprietors, these
6 new owners have continued to operate the networks with network-set interchange fees because they
7 believe that the use of such fees is the best way to compete for both card-issuing banks and ATM
8 owners.

9
10 **G. Development of ATM Surcharges and the Resulting Growth of ISOs.**

11
12 32. A “surcharge” is a charge that an ATM owner assesses directly upon an issuing
13 bank’s cardholder at the time that a cash withdrawal transaction is processed (as opposed to the
14 interchange fee, which the networks require to be paid by the issuing bank to the ATM owner).
15 Prior to 1996, many ATM networks prohibited or restricted ATM surcharges, and thus the revenue
16 stream from foreign ATM transactions that was realized by most ATM owners was restricted to
17 interchange fees.

18
19 33. Restrictions on surcharges had a limiting effect on deployment of ATMs, particularly
20 with respect to deployment of “off-premises” ATMs (*i.e.*, deployment at locations other than bank
21 branches), which are typically more expensive to operate than on-premises ATMs. Beginning in the
22 mid-1990s, however, network surcharge restrictions were lifted. Thereafter, as ATM owners saw an
23 opportunity to increase revenue from foreign transactions by combining interchange fees and
24 surcharges, the industry experienced an explosion of growth in ATM deployment. In particular,
25 non-bank entrepreneurial organizations called ISOs (Independent Sales Organizations) began to
26 place thousands of ATMs in locations that previously could never support a business case for an
27
28

ATM based solely on revenue generated by ATM interchange fees.³ These ATMs were not serving the customer base of any given bank. The business case for deployment of this new population of ATMs was the higher revenue suddenly available from the combination of ATM interchange and surcharge. Hence, ATMs appeared in geographies and venues never contemplated previously. This development in the ATM network industry created greater access to cash for consumers.

34. Even after surcharging became permissible, many banks still did not surcharge, and some elect not to do so even today. And many banks, particularly smaller banks (including especially credit unions and thrifts), have sought, as a competitive measure, to attract and retain deposit customers through participation in “no surcharge” sub-networks in which the participants mutually agree not to surcharge each others’ customers and also to provide reasonable notice of this “no-surcharge” opportunity. Finally, a recent trend in the industry is for banks, particularly small banks, to attempt to attract depositors by agreeing to “rebate,” or credit back to their customers, any surcharge that the customer might have to pay to another entity for a foreign ATM transaction.

I. The Influence of Interchange Fees on Network Participation by ISOs

35. ISOs, unlike card-issuing banks, have no cardholder customers for whom they seek access to the ATMs of other network members. All of their transactions are “foreign.” Rather, ISOs have as their principal interest maximizing the revenues that can be gained from usage of their ATMs by the cardholder customers of card-issuing banks. Thus, the combination of interchange fees plus surcharge revenues tends to be more important to an ISO’s ATM deployment decisions than is the case with a traditional bank, whose ATM deployment decisions are also affected by the competitive deposit-seeking advantage of providing more free “on us” transaction opportunities for its customers.

³ Today, around half of the ATMs located in the United States are owned or operated by ISOs. Indeed, the second largest ATM owner in the United States is an ISO, with more than 9,000 ATMs.

1 36. ATM interchange has always been part of the value equation that banks evaluate as
 2 they select networks, along with network proximity to a bank's core retail customer base, the mix of
 3 on-us and off-us traffic and other factors. With the introduction of ISOs, ATM interchange became
 4 an even more critical component for networks seeking to win business. Networks had to make
 5 certain that their ATM interchange fees were competitive for this new type of participant in the
 6 network. Indeed, a number of networks introduced segmentation in their interchange fees, creating
 7 an "off-premise" ATM interchange fee to assist in the recruitment of this new and rapidly growing
 8 segment of the ATM network participant base.⁴ Thus, the introduction of surcharges did not lead to
 9 the elimination of network interchange fees. To the contrary, the competitive importance of
 10 interchange fees increased.

11
 12 37. From a network perspective, upon the introduction of surcharges and the rise of ISOs,
 13 competition for bank and ISO business (*i.e.*, transaction volume that generates switch fees) became
 14 much more complex than previously had been the case. Eleven years after the introduction of
 15 surcharges, the marketplace for the ISO community is complex and highly competitive. Foreign
 16 ATM activity is a slow growth/no growth business. Most all viable ATM locations are taken;
 17 retailers who rent space for ATMs also want a share of the transaction revenue. ISOs carefully
 18 evaluate every aspect of the ATM network relationship to ensure maximum benefit. As a result,
 19 interchange fee pricing has become an even more critical component of competitive strategy for
 20 networks than it had been in the early growth years, and it remains an ongoing competitive tool
 21 among networks vying for ISO business.

22
 23
 24
 25
 26 ⁴ On-premises ATMs are virtually all owned by card-issuing banks that deploy the machines at their branches, in large
 27 part for use by their own customers. Card issuers may also deploy off-premises ATMs, which are typically more
 28 expensive to operate, but off-premises machines are the only machines deployed by ISOs.

J. Evolution of Modern Network Competition

38. While there are still a number of joint-venture ATM networks, today the major ATM networks have been acquired and are now owned by for-profit public companies that compete to deliver branded products and transactions services to banks, ISOs, and card-carrying consumers. The goal of these proprietary networks is to maximize network revenues generated from the switch fees that participants pay the network for routing and processing transactions. The former bank owners of the old joint venture networks have become the customers—often important customers—of these new proprietary networks.

39. Network competition has many dimensions, including standards, brand marketing and fees. The interchange fee in particular must be set at a level that provides appropriate incentives for both ATM owners and card issuers. It is considerably higher than the “switch fee” that the card-issuer bank pays the network for each transaction initiated by one of the bank’s customers. If a network’s interchange fees are not set at competitive levels, it will be likely to lose some participants to other networks (*i.e.*, card-issuer banks that view the combined amount of the interchange fee and network switch fee as too high a total cost, or ATM owners that view the interchange fee as inadequate).

40. Interchange fees are an integral part of a complex web of internal arrangements upon which a network’s operations are based. For example, higher interchange fees encourage broader ATM deployment, particularly by ISOs. Thus, since its inception Star had a higher ATM interchange fee for off-premises ATMs to encourage increased ATM deployment. Other ATM networks have used interchange fees in a similar manner to compete for business and to add value to the network for banks and consumers. At NYCE, we segmented the interchange and created a higher fee for off-premise ATMs specifically to attract more ISOs to our network. We were successful in that effort.

1 41. As for banks, the networks must compete with increasingly complicated value
2 proposition, as network service offerings, or potential offerings, expand. Interchange fees have been
3 a relatively stable part of those relationships, but their presence and a network's individual ability to
4 control them remains a significant tool for use when competing against other networks, especially in
5 the case of banks with large ATM populations.

6
7 42. A network's ultimate competitive goal in its ATM business is to increase network
8 traffic by offering ATM owners an active card base and by offering banks numerous, well-located
9 ATMs to be available to consumers. These interests must be balanced correctly for the network to
10 survive. For banks and ISOs both, interchange fee levels are one obvious point of comparison
11 among the various major regional and national ATM networks and thus are a factor in the decisions
12 they make about the networks in which they want to participate.

13
14 43. Another competitive factor that networks take into account when setting interchange
15 fees is that, in today's marketplace, major banks and ISOs belong to many networks to maximize
16 their respective economic interests. When a foreign transaction is made at an ATM, there is often an
17 option as to which network to send the transaction for authorization and the card issuer bank
18 generally gets to choose. This is called "issuer routing," and major networks such as NYCE and
19 STAR have policies permitting such a selection by an issuer bank.

20
21 44. Issuer banks typically will instruct that their cardholder transaction be routed through
22 the lowest cost network alternative. Banks and ISOs that are "net acquirers" (they take in more
23 network fees from acquiring ATM transactions than they pay out for cardholder activity – or, in the
24 case of ISOs, have no cardholder activity) can drop or join networks to generate the highest return
25 for their "acquiring" business. In both these circumstances, the interchange fee amount often plays a
26 significant role in the bank's or ISO's decision. Maintaining control over that element of foreign
27 ATM transactions thus remains critical to the ability of a network to compete for bank and ISO
28 participants.

1 45. Another element of the complex competitive landscape for networks today is the
 2 increasing prevalence of strategic negotiation with significant individual ISO and bank customers
 3 over the broad terms or the extent of their participation in a network (such as whether all operating
 4 subsidiaries of a bank holding company will join the network). Despite the competitive pressures
 5 that have led to such business-to-participant negotiations, however, the negotiations, and thus the
 6 network's ability to affect its membership and transaction volume (and its revenues and profits),
 7 remain within the control of the network and so the network can continue to accurately predict its
 8 business volume and operations and run itself accordingly. No network that wishes to compete
 9 effectively would want to entirely relinquish decisions about critical aspects of its operations to
 10 negotiations conducted strictly among its customers.

11
 12 46. Competition among networks today is primarily directed at card issuers and ATM
 13 owners (both banks and ISOs)—but the ultimate beneficiaries are consumers. Today U.S.
 14 consumers have a greatly expanded population and variety of ATM locations to choose from; due to
 15 network universal acceptance and the overlap of network coverage they are assured that virtually
 16 every card works in every ATM.

17 18 III

19 **OPINIONS REGARDING HYPOTHETICAL BILATERAL 20 NEGOTIATION OF INTERCHANGE TERMS AND FEES**

21 47. There are a number of possible scenarios for examining the impact on the ATM
 22 marketplace if I had to assume that a restriction were to be imposed that limited networks' ability to
 23 set and manage ATM interchange fees. For instance, such a restriction might be placed upon a
 24 single network, a group of networks (such as those operated as joint ventures) or the industry as a
 25 whole – with each circumstance generating different circumstances. I have attempted to summarize
 26 below what I considered some of the more likely business models that could evolve, or at least be
 27 attempted, as a result of an assumed interchange setting prohibition, and then to speak to how those
 28 changes could potentially impact the respective parties (banks, ISOs, networks and consumers.) At

1 the outset, however, I emphasize that even if one assumes such a prohibition somehow came to pass,
 2 it is difficult to construct a “what if” case in which consumers’ convenience and access are not
 3 compromised, and the network marketplace as a whole is not rendered substantially less efficient.

4
 5 **A. A Single Network Alone Is Prevented From Setting a System-Wide Interchange Fee**

6
 7 48. Based upon my experience in the ATM network industry, it is my opinion that a
 8 single network’s loss of control over interchange fee pricing would place it at a significant
 9 disadvantage within an industry dominated by other networks that could operate with network-set
 10 interchange fees. If a network (voluntarily or otherwise) required its members to reach separate
 11 bilateral agreements on the terms of foreign ATM transactions before such a transaction could occur
 12 between any two members, then unless 100% of the network members reached agreement and
 13 continuously maintained those agreements that network could not deliver on the industry standard
 14 commitment of “universal acceptance” of all of its members’ ATM cards at all ATMs in the
 15 network. Thus, whenever any two or more banks participating in the network were unable to reach
 16 or maintain agreements between or among them to honor cash withdrawal requests at their ATMs by
 17 other banks’ customers, universal acceptance would be lost and the card-issuing participant banks’
 18 customers would lose foreign ATM options – options which they have by now learned to expect and
 19 rely on. The same problem would also arise whenever any network participant tried to force
 20 unreasonable concessions from other participants or prospective participants in bilateral
 21 negotiations; the alternative to giving the concessions would be to end universal acceptance.

22
 23 49. Even if a network could achieve 100% bilateral agreements among its participants, it
 24 is my opinion that a network that required each ATM owner to have a separate and independent
 25 agreement with every card-issuing bank in the network in order to complete a foreign ATM cash
 26 withdrawal through the network would ultimately prove unworkable and would be unable to
 27 compete successfully with the other networks not restricted from system-wide interchange fees. Any
 28 such network structure would involve large transaction costs and introduce material risk of error and

1 service interruptions. In all likelihood, banks would not be interested in pursuing such negotiations
2 across all network participants given the time, expense and negligible return for the bank. Moreover,
3 the large differences in size and scale among banks would place small banks at a severe
4 disadvantage as they attempted to reach bilateral agreement with large banks, and they could
5 effectively be denied access or forced to pay exorbitant fees, and therefore would probably be unable
6 or unwilling to participate in such a network. It is therefore likely that the increased costs,
7 inefficiencies and risks created by then trying to maintain a bilateral regime would have the practical
8 result of causing banks to seek other, more efficient options (such as membership in proprietary
9 networks that had network-set interchange fees). Most banks and ISOs would either quickly or
10 eventually leave such a “bilateral network” in favor of another network that could deliver on the
11 implied commitment to consumers of universal acceptance and the associated economic
12 predictability of a bank’s or ISO’s participation. The “bilateral” network would then either
13 disappear altogether over time, or possibly break into smaller networks.

14
15 50. Finally, from the perspective of ISOs, which receive a significant percentage of their
16 revenue from interchange fees but never pay them, if an individual network, such as Star, suddenly
17 could not offer them any further interchange fee revenue, they would affiliate instead with
18 proprietary networks that provided the ISO with that revenue stream in addition to surcharge
19 opportunities. (It is overly simplistic to believe that any ISO could or would try to make up for lost
20 interchange fee revenue by simply raising surcharges. ISOs may not wish to take the risk that
21 consumers would be willing to pay the higher surcharges. In any event, it would be easy for the ISO
22 to make up the revenue simply by moving to a network that provided a system wide interchange
23 fee.)

24 **B. Some Networks Are Prevented From Setting a System-Wide Interchange Fee**

25
26 51. If one segment of the present ATM network industry, such as joint venture networks,
27 were no longer able to establish system-wide interchange fees, it is my opinion that all such
28

1 networks (and their participants) would be at the same very serious competitive disadvantage that a
 2 single “bilateral network” would face when they compete against “system-wide fee” networks. Such
 3 a change in the industry would also reduce competition among networks on a much larger scale than
 4 placing a restriction against system-wide interchange fees on one network alone. Although
 5 predicting all of the effects on competition would be a complicated exercise, each such network, and
 6 the consumers who benefit from its product, would suffer from ultimately increased costs and from
 7 what I believe would become a splintered, smaller ATM network industry.

8 **C. All Networks Are Prevented From Setting a System-Wide Interchange Fee⁵**

9
 10 52. Assuming that all networks could somehow be prevented from setting system-wide
 11 interchange fees, two network models might eventuate. The first would require direct bilateral
 12 negotiations over interchange fees between sets of network participants. For the reasons that I have
 13 already stated, the resulting change in the industry would likely be a larger number of much smaller
 14 networks and the disappearance of large networks. This would place consumers back into the less
 15 desirable position they were in decades ago, when there were few networks offering widespread
 16 geographic deployment of ATMs and consumers had to search for ATMs whose network brand
 17 matched the brand on their ATM card before they could be assured that their card would work in
 18 that ATM. In other words, requiring bilateral negotiation would at best result in fragmentation of
 19 today’s large, geographically spread, mega-participant ATM networks, leaving smaller networks
 20 (either by geography or number of participants) that offered consumers fewer options for cash
 21 withdrawals from foreign ATMs. I also believe that a hallmark of such “devolved” networks would
 22 be the absence of hundreds of smaller banks, who could be frozen out of participation.

23
 24 53. A second network form that might arise in the event of an externally imposed

25
 26 ⁵ This appears an extremely unlikely scenario which I offer simply for completeness of analysis. I am not sure how it
 27 could ever be achieved except by statute or perhaps some regulatory or enforcement agency. I simply assume this as a
 28 hypothetical and have no view as to whether this would be logical or legally coherent.

1 complete prohibition on system-wide interchange fees might be one where the network rules simply
 2 provided for reimbursement at par.⁶ Thus, the only compensation available under the network rules
 3 to ATM owners for agreeing to undertake foreign transactions would come from surcharges. In this
 4 model, it is likely that all ISOs would attempt to raise their surcharges from current levels in order to
 5 compensate for the loss of interchange fee revenue that they receive now. Large banks with large
 6 populations of ATM but relatively fewer cardholders (net acquirers) might well do the same
 7 (although predicting the customer pricing behavior of banks in such a situation is less certain
 8 because of the complexities of their strategies toward customer relationships), or they might enter
 9 into reciprocal agreements with other large banks to maintain a lower level of surcharges for their
 10 respective customers while elevating the surcharge amount only for other banks' customers in the
 11 network. While the concept of universal acceptance could operate in this model, this would be the
 12 model in which consumers would pay the highest surcharges – certainly higher than what they
 13 presently pay.

14 **D. Impact on Networks and Consumers of Eliminating System-Wide Interchange Fees**

15
 16 54. The combination of universal acceptance of ATM cards within networks, the
 17 increased size of networks over time and the fact most every bank and ISO belongs to at least one
 18 regional and one national network has led to many consumers developing the confidence today that
 19 they no longer need to even be aware of the network brand on their ATM card or to look for a brand
 20 on an ATM in order to know that their card will work in any ATM anywhere. However, if network
 21 interchange fees, and thus the acceptance of cards within a network from ATM to ATM, depended in
 22 any way on bilateral negotiation of interchange among network members, then universal acceptance
 23 of cards within those networks would either disappear altogether or the only networks that could
 24 offer universal acceptance would be those small enough to achieve, and maintain, 100% bilateral
 25 agreements among its members. In my opinion, the infeasibility of bilateral negotiations in a

26
 27 ⁶ That is, networks would be permitted to require an effective interchange fee of zero but would not be permitted to set a
 28 non-zero interchange fee.

1 network of any significant scale is one of the principal explanations as to why every major ATM
 2 network in the United States has always relied, and relies today, upon a common default interchange
 3 fee in lieu of bilateral negotiations.

4
 5 55. For example, it is not unreasonable in my opinion to project that large banks with
 6 established ATM fleets would have little incentive to invest the resources required to negotiate with
 7 the vast number of smaller banks and ISOs in any network, each of which has relatively smaller
 8 ATM fleets. Such banks might well decide to give up the identifiable economic cost, and the harder-
 9 to-calculate customer service benefit, of belonging to a network and instead rely solely upon their
 10 own fleets to deliver ATM access to their customers. Alternatively, they might form limited
 11 alliances with one or more other large banks or ISOs and thus bypass networks entirely. Whether
 12 either result evolved from the competitive elimination of a single network or that of an entire
 13 category of network, or an industry-wide compulsory change of business model, is immaterial; both
 14 results would shrink the transaction volume of all networks over time and, ultimately, increase
 15 network costs across the industry.

16
 17 56. No matter whether a restriction on system-wide interchange fees is network-specific,
 18 category-specific or industry-wide, no one can precisely predict how changes to what is today a
 19 mature, well-functioning and efficient payment system would play out, or what the reactions of each
 20 of the stakeholders in the marketplace might be. But it would not be at all unreasonable to predict
 21 that the divergent interests and unequal bargaining power of banks in the introduction of any
 22 bilateral system could force many small banks (including especially single branch institutions, credit
 23 unions and thrifts) and small ATM owners out of a network. Large institutions would not be likely
 24 to offer small banks or ISOs contract terms as consistently favorable as the “even playing field
 25 terms” existing under current network rules, and that, along with the increase in transaction costs due
 26 to bilateral negotiation requirements, would force many smaller institutions from the network(s).
 27 Also, if some segment of the population of vendors (banks, ISOs) that supply cash to consumers via
 28 ATMs receive a “pay cut” (*i.e.*, lower or no interchange fees) they would likely seek to try to recoup

1 that revenue shortfall via increased surcharges. Such a surcharge increase could result in some
 2 number of consumers paying a higher fee for access to their funds while, at the same time, causing
 3 some number of ATM owners to shut down their ATMs when they lose consumer traffic due to the
 4 higher surcharge.

5
 6 57. ATM networks, and the entire industry, have evolved from their earliest days,
 7 becoming increasingly complex. The core objectives of universal acceptance, a "level playing
 8 field," reliability and certainty for the network participants, and thus for consumers, remain critical
 9 to the industry, however, and therefore any sudden externally-imposed change on a historically
 10 important element of these systems is likely to have unanticipated and unintended consequences that
 11 would be disruptive of the consumer benefits that ATMs presently supply.

12
 13 I declare under penalty of perjury under the laws of the United States that the foregoing is
 14 true and correct.

15
 16 Executed at New Canaan, Connecticut on August 3, 2007

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 18 
 19 Dennis F. Lynch
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